

Bulletin 2002-3

TO: ALL LICENSED INSURERS

**RE: EXCLUSIONS RELATED TO ACTS OF TERRORISM
PERSONAL LINES PROPERTY & CASUALTY COVERAGES
LIFE INSURANCE
HEALTH INSURANCE
WORKERS' COMPENSATION**

FROM: KATHLEEN SEBELIUS, COMMISSIONER

DATE: April 15, 2002

Background

There has been some uncertainty in the insurance marketplace in light of the substantial losses experienced by the industry on September 11, 2001. Soon after the events, many reinsurers announced that they did not intend to provide coverage for acts of terrorism in future reinsurance contracts. This led to a concerted effort on behalf of all interested parties to seek a temporary federal backstop to calm market fears over future terrorists attacks and the ability of the insurance industry to allocate capital to provide coverage for these unpredictable and potentially catastrophic events. Unfortunately, Congress has been unable to reach agreement on the terms of a temporary federal solution. As a result, insurance regulators find themselves having to consider approval of certain coverage exclusions for acts of terrorism or risk possible serious solvency concerns in the insurance industry.

The intent of this bulletin is to inform you of the decision in this state related to exclusions of coverage for personal lines property and casualty insurance coverages, life insurance, accident and health insurance and workers' compensation.

Personal Lines Property and Casualty Products

The National Association of Insurance Commissioners (NAIC) considered the issue of whether it is appropriate to approve exclusionary language for acts of terrorism for personal lines property

and casualty insurance products. The following statement was adopted by the NAIC membership:

It is the sense of the NAIC membership that terrorism exclusions are generally not necessary in personal lines property and casualty products to maintain a competitive market and they may violate state law. However, we recognize that state laws vary in their authority and discretion. Further, there may be unique company circumstances that need to be considered in individual cases. We expect these cases to be limited.

As Commissioner, I was involved in recent discussions at the NAIC related to these important insurance regulatory issues. By this bulletin, I am informing you of my intent to act in a manner consistent with the recommendations from the NAIC membership. I believe this to be the best course of action as it balances the need of insurers to have some certainty related to solvency concerns with the consumer's concerns that their lives and financial well being not be subject to unnecessary uninsured events. Thus I do not intend to approve exclusions for acts of terrorism in personal lines contracts, unless an insurer is able to unequivocally demonstrate that it will become insolvent without approval of exclusionary language.

To date insurers have filed some unacceptable exclusions for either homeowners or personal auto insurance products. These endorsements will be disapproved for use in this state as inconsistent with the interests of public policy and inconsistent with the following provisions of law:

K.S.A. 40-216 and K.S.A. 40-951

Life and Health Insurance Products

The NAIC considered the issue of whether it is appropriate to approve exclusionary language for acts of terrorism for life insurance products and accident and health insurance products. The following statement was adopted by the NAIC membership:

It is the sense of the NAIC membership that terrorism exclusions are not necessary for individual life and health products, and are generally not necessary to maintain a competitive market for group life and health products. They also may violate state law. However, we recognize that state laws vary in their authority and discretion. Further, there may be unique company circumstances in the group market that need to be considered on a case-by-case basis. We expect these cases to be limited. We urge carriers and government entities to explore private and public pooling mechanisms in the group market and all other available alternatives to mitigate problems that arise from concentration of risk.

As commissioner, I was involved in recent discussions at the NAIC related to these important insurance regulatory issues. By this bulletin, I am informing you of my intent to act in a manner consistent with the recommendations from the NAIC membership. I believe this to be the best course of action as it balances the need of insurers to have some certainty related to solvency concerns with the consumer's concerns that their lives and financial well being not be subject to unnecessary uninsured events. Thus I do not intend to approve exclusions for acts of terrorism in

individual life or accident and health contracts. Further, I do not intend to approve exclusions for group life or accident and health contracts unless an insurer is able to unequivocally demonstrate that it will become insolvent without approval of exclusionary language.

To date insurers for a variety of insurance products have filed some unacceptable exclusions. These endorsements will be disapproved for use in this state as inconsistent with the interests of public policy and inconsistent with the following provisions of law:

40-444 and 40-2215(d)(2)(b)

Workers' Compensation Insurance

The NAIC's Workers' Compensation Task Force considered the issue of whether it is appropriate to approve exclusionary language for acts of terrorism for workers' compensation policies. The task force determined that it was inappropriate for an insurer to exclude workers' compensation coverage for acts of terrorism, as it is inconsistent with state law and contrary to public policy. This is true for this state as well as others. Therefore, no language that would exclude coverage for acts of terrorism will be approved in this state for workers' compensation policies.

The NAIC's Workers' Compensation Task Force also considered the appropriateness of adjusting advisory organization loss costs to include a 4% catastrophe load. The task force issued the following statement regarding the NCCI's Filing B-1377:

The task force has held two conference calls to discuss the recent filing by the NCCI for a 4% increase in loss costs for new, renewal and outstanding workers' compensation policies. The reason given by the NCCI for this proposed increase was it felt that it was necessary to recognize expected losses arising from terrorism in the future. The task force recognizes that NCCI uses the term "expected" loss in the mathematical sense, rather than as a foregone conclusion that future acts of terrorism will result in significant catastrophe losses for workers' compensation insurers.

Most regulators on the conference calls expressed reservations about application of a change of this nature to outstanding policies without a change in coverage from judicial or legislative action. Concern was also expressed regarding the amount of the requested increase. As a practical matter, it was recognized that some insurers might already be including catastrophe provisions implicitly in their loss cost multipliers for many states. There were also some reservations about using policyholder funds to pre-fund catastrophe reserves without tax deferral. The public interest may require broader solutions.

The task force believes that the proper recognition of catastrophe losses in loss costs, including those losses arising from terrorism, is an important subject that justifies additional discussion by the task force. As such, the task force intends to discuss workers' compensation catastrophe ratemaking procedures and to keep abreast of discussions and developments of this subject and related subjects by others, including but not limited to

the American Academy of Actuaries, the NCCI, and the Congress. These discussions will also include a review of subjects related to pre-funded catastrophe reserves and reinsurance for catastrophes, where the catastrophes involve a significant workers' compensation element.

It is not the intention that this discussion will necessarily result in a report or set of recommendations. It is recognized that the most appropriate actions related to the recognition of catastrophe losses in rates or loss costs are likely to vary from state to state or even from company to company. Rather, it is the intention of the task force that its discussions will facilitate the identification of problems and may provide guidance to their eventual solutions.

As Commissioner, I was involved in recent discussions at the NAIC related to workers' compensation exclusions and adding a catastrophe factor to loss costs. By this bulletin, I am informing you of my intent to act in a manner consistent with the recommendations from the NAIC membership. I believe this to be the best course of action as it balances the need of all parties. I recognize that workers' compensation insurers may have some short-term difficulties obtaining adequate catastrophe reinsurance, however, state law and the proper functioning of the insurance marketplace dictate that all exclusions for acts of terrorism in workers' compensation policies, primary as well as excess, be disapproved. I plan to follow the discussions related to workers' compensation catastrophe ratemaking procedures and will act on the recommendations related to the addition of a catastrophe factor to workers' compensation loss costs at an appropriate time.

If you have questions related to the matters in this bulletin, please contact:

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